



COLORADO
Department of Revenue

Taxation Division

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PLR-18-003

May 23, 2018

XXXXXX

Attn: XXXXXX

XXXXXX

XXXXXX

Re: XXXXXX

Dear XXXXXX,

You submitted a request for a private letter ruling on behalf of your client XXXXXX (“Company”) to the Colorado Department of Revenue (“Department”) pursuant to Department Rule 24-35-103.5. This letter is the Department’s private letter ruling. This ruling is binding on the Department to the extent set forth in Department Rule 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Issue

1. Is Company’s purchase of parts, materials, and consumables that are incorporated into the Prototype exempt from sales and use tax?
2. If the cost of the Prototype exceeds the proceeds from the sale of the Prototype, would the Department treat the costs related to manufacturing the Prototype subject to sales or use tax?
3. If a buyer cannot be found for the sale of the Prototype and the Department determines that Company’s purchase of the materials incorporated into the Prototype are subject to tax, when is the use tax due on the cost of the Prototype?
4. If the Prototype is used for internal purposes at the end of testing, would the Department consider the machinery and equipment used to build the Prototype to be taxable?
 - a. If taxable, when is the use tax due on such materials?
 - b. Would the date the use tax is due on the machinery and equipment follow the date that use tax is due on the materials used to build the Prototype?

5. Are the federal income tax credits and sales and use tax treatment exclusive of each other? If Company claims the research and development credit, can Company purchase the materials exempt from sales and use taxes for resale?

Conclusion

1. Company's purchases of parts that are incorporated into the Prototype are exempt from sales and use tax.
2. This issue is moot because the Department determines that Company's purchases of the parts are exempt.
3. This issue is moot because the Department determines that Company's purchases of the parts are exempt.
4. Machinery and machine tools used to manufacture the Prototype are exempt from sales and use taxes, regardless of whether the subsequent sale of the Prototype is subject to sales or use taxes.
5. Company's anticipated claim for federal depreciation expense for the Prototype is consistent with the Department's conclusion that Company is using the Prototype for sales and use tax purposes.

Background

Company proposes to engage in the manufacture of commercial aircraft capable of carrying XXXXXX passengers and intends to sell such aircraft to third parties that operate commercial passenger airline service. Company is currently in the research and development stage for its aircraft and intends to build a prototype XXXXXX version of the aircraft ("Prototype") that Company will use to perform flight testing. Company expects flight tests to be rated at XXXXXX hours and the initial useful life of the Prototype is expected to be XXXXXX hours, which can be extended several times by normal maintenance and refurbishment.

Company may sell the Prototype to raise revenue after it completes testing the Prototype. Company would not sell the Prototype as a commercial passenger aircraft. Company may not be able to find a buyer for the Prototype. If a buyer cannot be found, then Company may use the Prototype for marketing the full-scale versions of the aircraft. The cost to build the Prototype is expected to exceed the price at which Company can sell the Prototype. Company will purchase machinery and machine tools to manufacture the Prototype.

Discussion

1. *Are Company's purchases of parts that are incorporated into the Prototype exempt from sales and use tax?*

Colorado levies sales and use tax on the retail sale, use, storage and consumption of tangible personal property.¹ Colorado provides a number of exemptions from these taxes and two of those exemptions are pertinent here. The first exemption applies to the purchase and use of components used in the manufacture of tangible personal property for sale.² This exemption was enacted to avoid pyramiding of taxes for manufactured and compounded goods subsequently sold as a taxable retail transaction.³

Company's purchase of components used to manufacture the Prototype do not fall within this exemption. This exemption does not apply if the manufacturer is the primary user and consumer of the manufactured good.⁴ In this case, the primary purpose for building the Prototype is not to sell the Prototype as a commercial product but, rather, to use it to conduct research and development for the development of a full-scale version of the aircraft. The sale of the Prototype after that use is secondary to this purpose and is itself, a separate transaction.

Company cites to Department PLR 15-002 in support of its contention that its purchase of components are exempt from tax. In that ruling, the Department ruled that a company was not liable for sales or use tax on manufacturing components, even though the company engaged in extensive testing of the manufactured final product prior to its sale to a third-party buyer. The Department concluded that a manufacturer's testing of its goods that are ultimately sold is part of the manufacturing process and is not, in and of itself, a taxable use. PLR 15-002 is not applicable to this case because Company's primary purpose in building the Prototype is for its own research and development and not to ensure that the Prototype will operate properly when sold.

The ruling here is consistent with Colorado case law. In *AB Hirschfeld v. City and County of Denver*, 806 P.2d 917 (Colo. 1991), the court held that whether a purchase of tangible personal property is a nontaxable purchase for resale or a taxable purchase depends on whether the purchaser's primary purpose was to resell the property or to use the property prior to resale. A similar analysis was applied in *General Motors Corporation v. City and County of Denver*, 990 P.2d 59 (Colo 1999), in which the court held that the manufacturer's use of motor vehicles in extensive testing was a taxable use by the manufacturer even though the manufacturer later sold the vehicles. Although the Prototype will be ultimately resold, Company will extensively use the Prototype for research, development,

¹ 39-26-104(1) and 202, C.R.S.

² 39-26-102(20) and 713(2)(e)(I), C.R.S.

³ *Carpenter v. Carman Distributing Co.*, 144 P.2d 770 (Colo. 1943)

⁴ *Ibid.* This is consistent with the similar tax principle that a buyer cannot claim a purchase is a non-taxable wholesale purchase for resale if the buyer uses the product prior to resale. See, e.g., GIL 13-027 (taxpayer not entitled to claim purchases are non-taxable wholesale purchases for resale when the taxpayer uses the product prior to reselling it.).

and marketing and, therefore, has engaged in a taxable use of the property and does not qualify for exemption under this exception.

The second exemption at issue here is the exemption for aircraft parts.⁵ Specifically, this statute exempts from sales and use tax, “[t]he sale of tangible personal property that is to be permanently affixed or attached as a component part of an aircraft.”

The Department has previously given guidance that the purchase of fuselages and other large components of an aircraft are exempt under this statute.⁶ Company represents that the aircraft components will be permanently affixed or attached to an aircraft. These purchases satisfy the requirements of this exemption and, therefore, the Department rules that Company’s purchase of such parts are exempt from state sales and use taxes under the aircraft parts exemption.⁷

- 2. If the cost of the Prototype exceeds the proceeds from the sale of the Prototype, would the Department treat the costs related to manufacturing the Prototype subject to sales or use tax?*

This issue is moot because the Department determines that Company’s purchases of parts are exempt.

- 3. If a buyer cannot be found for the sale of the Prototype and the Department determines that Company’s purchase of the materials incorporated into the Prototype are subject to tax, when is the use tax due on the cost of the Prototype?*

This issue is moot because the Department determines that Company’s purchases of parts are exempt.

- 4. If the Prototype is used for internal purposes at the end of testing, would the Department consider the machinery and equipment to be taxable?*

Machinery and machine tools used to manufacture tangible personal property are exempt from sales and use taxes, regardless of whether the subsequent use or

⁵ §39-26-711, C.R.S. The Department considered whether this exemption is limited to aircraft used in interstate commerce as is the exemption for the purchase of aircraft in 39-26-711(1)(a), C.R.S. but determines that these are two separate exemptions.

⁶ See FYI Sales 85.

⁷ The Department has taken the position that the purchase of a build-your-own airplane kit is the purchase of an airplane and not simply the purchase of airplane parts and, therefore, denied claims that this exemption applied. In this case, Company is purchasing parts from a variety of suppliers and no single purchase can be viewed as anything other than the purchase of a part.

sale of the manufactured product is subject to sales or use taxes.⁸ The building of an aircraft is manufacturing. Company represents that the machinery and machine tools are used to manufacture the Prototype and, thus, are exempt from sales and use taxes.

5. Are the federal income tax credits and sales and use tax treatment exclusive of each other? If Company claims the research and development credit, can Company purchase the materials exempt from sales and use taxes for resale?

The Internal Revenue Code allows taxpayers to claim depreciation expenses for certain research and development products.⁹ This depreciation and the concept of a useful life for property imply that the taxpayer is using the depreciated property. In PLR 15-002, the Department ruled that, under the specific facts of that case, taxpayer's claim for depreciation expense was not inconsistent with taxpayer's claim that it was not using the manufactured product for purposes of sales and use taxes. In this case, it is clear Company is using and consuming the Prototype and Company's anticipated claim for depreciation expense for the Prototype is consistent with our conclusion.

Miscellaneous

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts and that all representations are true and complete. The Department reserves the right, among others, to independently evaluate Company's representations and assumptions. The ruling is null and void if any such assumption or representation is incorrect and has a material bearing on the conclusions reached in this ruling and is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

This ruling is binding on the Department to the extent set forth in Department Regulation 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

⁸ See, PLR 14-003 (the exemption for manufacturing machinery applies even when the manufacturer uses and consumes the manufactured goods). There are a number of requirements for manufacturing machinery exemption. §39-26-709, C.R.S. The Department is not determining in this ruling whether Company's machinery satisfies all these requirements, but only that building an aircraft is manufacturing and that this exempt does not require a subsequent taxable sale of the Prototype in order for the exempt to apply.

⁹ See PLR 15-002 for discussion

Sincerely,

Neil Tillquist
Colorado Department of Revenue
Office of Tax Policy & Analysis

This ruling cannot be relied upon by any other taxpayer other than the taxpayer to whom the ruling is made.